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Supreme Court of the United States

OCTOBER TERM, 1944

No. 956

MRS. S. W. C. LUMPKIN, PETITIONER,

versus

WM. P. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE STATE OF SOUTH CAROLINA, RESPONDENT

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Columbia, S. C.,
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Petition for Writ of Certiorari Filed _____
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TABLE OF CONTENTS

CASES CITED

Statute

Supreme Court of the United States

OCTOBER TERM, 1944

No. ____

MRS. S. W. C. LUMPKIN, PETITIONER,

versus

WM. P. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE STATE OF SOUTH CAROLINA, RESPONDENT

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

To the Honorable, the Supreme Court of the United States:

I

This is an application for a Writ of Certiorari for a review of the decision of the United States Circuit Court of Appeals of the Fourth Circuit reversing a judgment of the United States District Court for the Eastern District of South Carolina.

II

Summary Statement of the Matter Involved

This is an action at law instituted in the District Court of the United States for the Eastern District of South Car-

olina by the petitioner herein against the respondent for the recovery of individual federal income taxes alleged to have been overpaid for the years 1936 and 1937, upon the ground that such taxes were illegally assessed and collected.

The petitioner had a life interest under a trust created for her benefit in one-half of the stock of a corporation which was the owner of valuable franchise rights in the sale and distribution of coca-cola syrup. At the time her brother-in-law owned the other one-half interest in the stock of said company and upon his death in 1929 his stock interest in said company passed under his will to five trustees to hold the same for the benefit of an orphanage asylum. Thereafter, in 1930, the petitioner purchased the stock from the trustees for $255,885.00, and she continued to hold the same and enjoy the dividends and profits flowing therefrom. The record discloses that one-half of the average yearly income of said company for the years 1929 to 1935 was more than $21,820.34. In 1936 a suit was instituted against the petitioner in the courts of South Carolina, on Relation of the Attorney General, wherein it was sought to have the sale of the said stock rescinded upon repayment to petitioner of the purchase price thereof, with interest, and to require the petitioner to account for all income and profits received from said stock since she acquired it from the trustees. It was claimed in said action that the said trustees were not authorized under the will to make such sale. The petitioner, for the necessary protection and conservation of her rights and interest in said stock, including dividends received therefrom, retained attorneys to represent her interest in said action, and incurred other expenses in the defense thereof; the action was tried in due course and was finally terminated by the judgment of the Supreme Court of South Carolina adjudicating that said sale had been lawfully made. In connection with this litigation the petitioner

incurred expenses of $250.00 in 1936 and $26,250.00 in 1937, covering costs and attorneys' fees, which sums were deducted from the gross income in computing her net income tax for these years. The Commissioner of Internal Revenue disallowed these deductions and assessed additional taxes and interest against her of $155.00 for the year 1936 and $19,187.72 for the year 1937. These deficiency taxes were paid under protest and form the basis of this action.

The petitioner claims that expenditures made by her covering attorneys' fees and other legal expenses in the defense of a suit brought against her to set aside the sale to her of shares of capital stock in a corporation held for the production of income are properly deductible expenses in computing net income under Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats. 798, 819), which amendment was by its terms retroactive.

The position taken by the respondent is that the attorneys' fees and other legal expenses incurred by the taxpayer in the defense of title to stock were capital expenditurs to be added to the cost of the stock, and therefore not deductible.

Proceedings Below: The District Court held that the expenditures made by the petitioner were ordinary and necessary and were incurred for the purpose of preserving and conserving valuable property held by her for the production of income and to make secure the income she had already received, and upon which she had previously paid income taxes. It was held that even though such expenses were primarily incurred in the defense of title to stock in a corporation, such expenses were deductible in that they were expended for the conservation, maintenance and management of property held for the production of income and therefore such expenses were deductible under the Act,

as amended. Judgment was accordingly rendered in favor of the petitioner against the respondent in the sum of $22,680.10.

The Circuit Court reversed the judgment of the District Court and held that such expenses were not deductible under said Act, as amended, upon the following grounds:

(a) The purpose of the amendment was to permit deductions for certain "non-trade" or "non-business" expenses, and to thereby enlarge the allowable deductions which under previous Revenue Acts had been confined to "expenses paid or incurred in carrying on of any trade or business".

(b) It was not the intention of Congress to remove any other restrictions or limitations applicable to the deductions under the Act.

(c) Prior to the amendment it was uniformly provided that expenses incurred in defending or protecting title to property were not "ordinary and necessary expenses" and therefore not deductible.

(d) That the Congress used the phrase "all ordinary and necessary expenses", under the caption of "non-trade or non-business expenses" in the same sense and with the same limitations as it had previously used in connection with trade or business expenses.

(e) The expenses were incurred in the defense and protection of title to property and therefore, under the Treasury Regulations and decision of the Court's interpretative thereof, are not "ordinary and necessary expenses" and accordingly not deductible.

(f) The term "conservation" as used in the amendment cannot be given the meaning contended for by the petitioner without losing sight of the purpose which Congress intended to accomplish and the settled meaning that the

phrase "ordinary and necessary expenses" has been given in the administration and re-enactment of the Federal Income Tax Statutes.

III

Reasons Relied on for the Allowance of the Writ

(1) The decision of the Circuit Court of Appeals is erroneous in that it did not interpret Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats. 798, 819), in accordance with the ordinary, popular or received import of the words used therein. Thereby the Court decided an important Federal question in a way probably in conflict with applicable decisions of this Court. *Deputy et al. v. DuPont*, 308 U. S., 488, 60 S. Ct. Rep., 363, 84 L. Ed., 416; *A Magnano Co. v. Hamilton*, 292 U. S., 40, 54 S. Ct. Rep., 599, 78 L. Ed., 1109; *Maillard v. Lawrence*, 16 How., 251, 261; 14 L. Ed., 925.

(2) The decision of the Circuit Court of Appeals is erroneous in that it interpreted the term "conservation" as used in the Revenue Act of 1942, in a narrow and restricted sense and in a way to defeat the plain and obvious intent of Congress. Thereby the Court decided an important Federal question in a way probably in conflict with applicable decisions of this Court, and in a way probably untenable and in conflict with the weight of authority. *Helvering v. Hammel*, 311 U. S., 504, 61 S. Ct. Rep., 368, 85 L. Ed., 303, 131 A. L. R., 1431; *Helvering v. Stockholms Enskilda Bank*, 293 U. S., 84, 55 S. Ct. Rep., 50, 79 L. Ed., 211.

3. The decision of the Circuit Court of Appeals is erroneous in that under the terms of Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942, (56 Stats. 798, 819), expenses incurred in the conservation of property held for the production of

income are deductible even though such expenses were incurred in defense of a law suit involving title to such property. Thereby the Court decided an important question of Federal law which has not been, but which should be settled by this Court.

4. The decision of the Circuit Court of Appeals is erroneous in that it holds that Congress, in amending Section 23(a) of the Internal Revenue Code by the Revenue Act of 1942, used the phrase "all the ordinary and necessary expenses"; under the caption "non-trade or non-business expenses" in the same sense and within the same limitations that it had previously used in connection with trade and business expenses, which construction was not consonant with the purposes of the statute as disclosed by its structure. Thereby the Court decided an important Federal question in a way probably in conflict with applicable decisions of this Court. *Helvering v. Hammel,* 311 U. S., 504, 61 S. Ct. Rep., 368, 85 L. Ed., 303, 131 A. L. R., 1431.

5. The Circuit Court of Appeals erred in failing and refusing to hold that by operation of the 1942 amendment the regulations promulgated by the Secretary of the Treasury, to the effect that expenses incurred in defending title to property are not deductible in computing net income, are a nullity and unenforceable with respect to expenses incurred in defending title to property held for the production of income. Therefore the Court decided an important Federal question in a way probably in conflict to applicable decisions of this Court. *Koshland v. Helvering,* 298 U. S., 441, 56 S. Ct. Rep., 767, 80 L. Ed., 1268; *Manhattan General Equipment Company v. Commissioner of Internal Revenue,* 297 U. S., 129, 56 S. Ct. Rep., 397, 80 L. Ed., 528.

6. The Circuit Court of Appeals erred in giving application and effect to regulations promulgated by the Secretary of the Treasury which are in conflict with and neces-

sarily restrict the clear and unambiguous provisions of Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942. Thereby the Court decided an important Federal question in a way probably in conflict with applicable decisions of this Court. *Koshland v. Helvering*, 298 U. S., 441, 56 S. Ct. Rep., 767, 80 L. Ed., 1268; *Manhattan General Equipment Company v. Commissioner of Internal Revenue*, 297 U. S., 129, 56 S. Ct. Rep., 397, 80 L. Ed., 528.

WHEREFORE, your petitioner prays that a Writ of Certiorari issue under the seal of this Court directed to the Circuit Court of Appeals for the Fourth Circuit, demanding said Court to certify and send to this Court the full and complete transcript of the record and of the proceedings of said Circuit Court had in the case numbered and entitled on its Docket 5200, Wm. P. Bowers, Collector of Internal Revenue, Appellant, versus Mrs. S. W. C. Lumpkin, Appellee, to the end that this cause may be reviewed and determined by this Court as provided for by the Statutes of the United States; and that the judgment of the Circuit Court of Appeals may be reversed by the Court, and for such further relief as this Court may deem proper.

Respectfully submitted,

PINCKNEY L. CAIN,
R. BEVERLEY HERBERT,
Attorneys for Petitioner.

Columbia, S. C.,
April 13, 1944.

Supreme Court of the United States

OCTOBER TERM, 1944

No. ----

MRS. S. W. C. LUMPKIN, PETITIONER,

versus

WM. P. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE STATE OF SOUTH CAROLINA, RESPONDENT

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

Opinions of Courts Below

The opinion of the United States District Court for the Eastern District of South Carolina is reported in 50 Fed. Supp., 874. The opinion of the Circuit Court of Appeals is reported in --- Fed. (2d), ----.

II

Jurisdiction

The judgment of the Circuit Court of Appeals was entered February 4, 1944. The jurisdiction of this Court is

invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, Sec. 1, 43 Stats., 938 (28 U. S. C., 347(a)).

III

Statute Involved

Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819).

"Sec. 121. Non-trade or non-business deductions

"(a) Deduction for expenses. Section 23(a) (relating to deduction for expenses) is amended to read as follows:

"(a) Expenses.

"**Trade or business expenses.**

"(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, or property to which the taxpayer has not taken or is not taking title or in which he has no equity.

"(B) **Corporate charitable contributions.** No deduction shall be allowable under subparagraph (A) to a corporation for any contribution or gift which would be allowance as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained and for the requirement therein that payment must be made within the taxable year.

"(C) **Expenditures for advertising and good will.** If a corporation has, for the purpose of computing its

excess profits credit under Chapter 2E, claimed the benefits of the election provided in Section 733, no deduction shall be allowable under subparagraph (A) to such corporation for expenditures for advertising or the promotion of good will which, under the rules and regulations prescribed under section 733(a), may be regarded as capital investments.

"(2) **Non-trade or non-business expenses.** In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

"(b) **Allocable to exempt income.** Section 24(a)(5) (relating to items not deductible) is amended by inserting after 'this chapter' the following: 'or any amount otherwise allowable under section 23(a)(2) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this chapter.'

"(c) **Depreciation deduction.** The first sentence of section 23(l) (relating to deduction for depreciation) is amended to read as follows: 'A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for absolescence)—

"'(1) of property used in the trade or business, or

"'(2) of property held for the production of income.'

"(d) **Taxable years to which amendments applicable.** The amendment made by this section shall be applicable to taxable years beginning after December 31, 1938.

"(e) **Retroactive amendment to prior revenue acts.** For the purposes of the Revenue Act of 1938 or any prior revenue Act the amendments made to the Internal Revenue Code by this section shall be effective as if they were a part of such revenue Act on the date of its enactment."

IV

Statement of the Case

A full statement of the case has been under the heading "II" in the petition and to avoid duplication is not repeated (pages ___ to ___ inclusive, *supra.*)

V

Specifications of Error

(1) The Circuit Court of Appeals erred in refusing to interpret Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819), in accordance with the ordinary, popular and received import of the words used therein, and in a way so as to effectuate the purposes of Congress.

(2) The Circuit Court of Appeals erred in interpreting the term "conservation" as used in Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819), in a narrow and restricted sense and in a way to defeat the plain and obvious intent of Congress.

(3) The Circuit Court of Appeals erred in not finding and holding that under the terms of Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819), expenses incurred in the conservation of property held for the production of income are deductible even though such expenses were incurred in the defense of a law suit involving title to such property.

(4) The Circuit Court of Appeals erred in finding and holding that Congress, in amending Section 23(a) of the Revenue Act of 1936, used the phrase "all the ordinary and

necessary expenses'' under the caption ''non-trade or non-business expenses'' in the same sense and within the same limitations that it had previously used in connection with trade or business expenses.

(5) The Circuit Court of Appeals erred in failing and refusing to hold that the regulations promulgated by the Secretary of the Treasury, to the effect that expenses incurred in defending title to property are not deductible in computing net income, are a nullity and unenforceable with respect to expenses incurred in defending title to property held for the production of income, by reason of Section 23(a) of the Revenue Act of 1936, as amended by Section 121 of the Revenue Act of 1942 (56 Stats., 798, 819).

VI

ARGUMENT

I

The Circuit Court of Appeals Did Not Interpret Section 23(a), as Amended, in Accordance with the Ordinary, Popular and Received Import of the Words Used Therein and in a Way so as to Effectuate the Purposes of Congress.

As developed by the statement of facts, *supra*, the petition, prior to 1929, held a life estate in a one-half interest in a corporation which was the owner of valuable franchise rights in regard to the sale and distribution of coca-cola syrup. In 1930 she purchased in her own right the other one-half interest in the stock of this company for the sum of $255,885.00, and for several years thereafter managed and directed the affairs of said company, during which time she received the dividends declared and paid on such shares of stock. In 1936 a suit was brought against her to set aside

the sale of the stock she acquired in 1930, upon the ground that the trustees from whom she purchased it had no authority to make such sale, upon the repayment to her of the purchase price thereof, with interest. In this suit it was also sought to require the petitioner to account for all income and profits from the said stock which she had received from the date she purchased it until the time of the institution of the suit. The petitioner employed attorneys to defend and conserve her interest in said stock and to sustain the validity of the sale, and in doing so she incurred expenses, covering costs, attorneys' fees and printing, etc., amounting to $250.00 during the year 1936, and $26,798.22 during the year 1937. These items were deducted by her in computing her net income for these respective years but such deductions were disallowed and as a result thereof a deficiency tax and interest was assessed against her in the sum of $19,342.72, which taxes were paid under protest. It is further developed by the record that in addition to the demand for an accounting of the dividends received from said stock during the time the petitioner held the same, the State also contended that the petitioner, for herself and for the benefit of her general manager, withdrew excessive salaries and claimed that if said salaries were adjusted to a reasonable basis, one-half of the average yearly income of said company for the years 1929 to 1935 would be $21,820-.34. It was further shown that if the sale was rescinded and the petitioner was paid the legal rate of interest on her investment, she would have received the sum of $14,353.10 for each of these years, which, if deducted from dividends received, would leave the sum of $6,467.24, for which the petitioner would be required to account each year for six years. It was further shown that the dividends declared by the company for the years 1936 and 1937 were greatly in excess of the dividends paid for the previous years. It is

conceded that the dividends received from this stock by the petitioner were required to be and actually were included in income for Federal income tax purposes, and taxes were paid thereon for the respective years.

We respectfully submit that if the statute in question is interpreted in accordance with the ordinary, popular and received import of the words used therein and in a way so as to effectuate the purpose and intent of Congress, the legal expenses incurred by the taxpayer are deductible because they were incurred in the conservation of property held for the production of income. The Government contends, and the Court below so held, that prior to the amendment of Section 23(a) it was firmly established by treasury regulations and decisions construing the same that legal expenses involved in defending or protecting title to property are not "ordinary and necessary expenses" and therefore not deductible from the gross income in order to compute the taxable net income, and contends further that such regulations and ruling are not affected by the 1942 amendment. No question is raised as to the reasonableness of the fee paid or the costs incurred, nor is it questioned that such expenses bore a reasonable proximate relation to the conservation of property held for the production of income.

The language used by Congress in the amendment demonstrates a clear and positive purpose to change the treasury regulations relied upon by the Government and to neutrailize any decisions giving effect thereto so as to now permit the deduction of expenses necessitated by the urgency of defending title to property held for the production of income, and that now, if such expenses are incurred for this purpose they should be regarded as ordinary and necessary notwithstanding the use made of this term prior to the amendment.

The Court below, we respectfully submit, did not i
terpret the statute in the light of the evil of the administr
tive practices it was sought to correct and in accordan
with the ordinary, popular and accepted meaning of t
words used therein; on the other hand the Court deduc
from the statute an interpretation not justified by its stru
ture. The decision superimposes on the language used t
interpretation of prior regulations defining the meaning
the phrase "ordinary and necessary" and holds that t
Congress did not intend to remove such restrictions a
limitations theretofore applicable to deductions under Se
tion 23(a) of the Act.

The language used in the amendment is clear and u
ambiguous and the purpose sought to be accomplish
thereby is likewise obvious and free from doubt. The p
mary function of the income tax laws is to raise reven
and this amendment furthers and supplements this pu
pose. In order to increase the income affected by the A
taxpayers, by the amendment, are encouraged to prote
and conserve income producing properties, and to this e
they are allowed to deduct from their gross income expe
ses, ordinarily and necessarily incurred, in connection wi
the production of income or the conservation of proper
held for the production of income. The Congress did n
make a distinction between the nature of deductible
penses so long as they were incurred in obtaining one
the ends to be gained, namely, either for the production
income or for the conservation of property held for the p
duction of income. The Court below held that it was the
tention of Congress to allow only such deductions as h
been previously defined by the Treasury Department to
ordinary and necessary and that under this definition
penses incurred in defending title to property were not
ductible.

It is respectfully submitted that if Congress had so intended it could have said so; but on the contrary, by the very language used declared that such regulations should no longer be effective where the expenses were concerned with the production of income or the conservation of property held for the production of income. While it is generally true that the statute creating exemptions must be strictly construed and that any doubt must be resolved in favor of the taxing power, it is also true that a strict construction is not called for where a common sense construction squares the plain and obvious intent of Congress. The language used by the Congress is unfettered by exceptions or nice distinctions but employs words of generally accepted and unambiguous meaning.

This Court, in *Deputy et al. v. DuPont*, 308 U. S., 488, 60 S. Ct. Rep., 363, 84 L. Ed., 416, said:

> "And when it comes to construction of the statutory provisions under which the deduction is sought, the general rule that 'popular or received import of words furnishes the general rule for the interpretation of public laws', *Maillard v. Lawrence*, 16 How. 251, 261, 14 L. Ed. 925 is applicable."

In the earlier case of *A. Magnano Co. v. Hamilton*, 292 U. S., 40, 54 S. Ct. Rep., 599, 78 L. Ed., 1109, it was said:

> "The statute here under review is in form plainly a taxing act, with nothing in its terms to suggest that it was intended to be anything else. It must be construed, and the intent and meaning of the Legislature ascertained, from the language of the act, and the words used therein are to be given their ordinary meaning unless the context shows that they are differently used."

There is nothing in the statute to indicate that the Congress used the words other than in their ordinary and popular meaning. It is accordingly submitted that the Court below decided an important Federal question in a way probably in conflict with applicable decisions of this Court.

II

The Circuit Court of Appeals Erred in Interpreting the Term "Conservation" as Used in the Statute in a Narrow and Restricted Sense and in a Way to Defeat the Plan and Obvious Intention of Congress.

The statute plainly declares that ordinary and necessary expenses incurred in the "conservation" of property held for the production of income shall be deductible. In the opinion of the Court below the meaning and connotation of this term is so narrowed and restricted as to make it applicable only to the safeguarding or protection of tangibles and did not give to such term its commonly accepted meaning. There is nothing in the context to indicate that the term was to be construed in a manner different from its ordinary and generally understood meaning. The term "conservation" has been defined as follows: "The act of preserving, guarding, or protecting; preservation from loss, decay, injury, or violation; the keeping (of a thing) in a safe or entire state." Webster's Twentieth Century Dictionary, page 360.

This Court, in *Helvering v. Hammel*, 311 U. S., 504, 61 S. Ct. Rep., 368, 85 L. Ed., 303, 131 L. R. A., 1431, said:

> "True, courts in the interpretation of a statute have some scope for adopting a restricted rather than a literal or usual meaning of its words where acceptance of that meaning would lead to absurd results. *United States v. Katz*, 271 U. S. 354, 362, 46 S. Ct. 513, 516, 70 L. Ed. 986, or would thwart the obvious purpose of the statute, *Haggar Co. v. Helvering*, 308 U. S. 389, 60 S. Ct. 337, 84 L. Ed. 340. But courts are not free to reject that meaning where no such consequences follow and where, as here, it appears to be consonant with the purposes of the Act as declared by Congress and plainly disclosed by its structure."

We therefore submit that in giving the term "conservation" a restricted rather than its usual meaning and in a way so as to defeat the purposes of the Act, the Court decided a question of Federal law in way probably different from the applicable decisions of this Court.

III

The Court Erred in Not Holding That Under the Terms of the Statute Expenses Incurred in the Conservation of Property Held for the Production of Income Are Deductible, Even Though Such Expenses Were Incurred in the Defense of a Law Suit Involving Title to Such Property.

It is true that prior to the 1942 amendment the Treasury Department had uniformly ruled that expenses incurred in defending title to property were not ordinary and necessary expenses, as that term had been used in previous revenue laws, and therefore were not deductible. However, in the 1942 amendment the Congress did not indicate that the phrase "ordinary and necessary" was differently used from its ordinary meaning, nor did it restrict the meaning of the term "conservation". We therefore submit that if legal expenses were incurred in defending title to property held for the production of income, such expenses fall within the terms of the amendment and are deductible. The Court, in holding to the contrary, decided a question of Federal law which has not been but which should be settled by this Court.

IV

The Court Erred in Holding That Congress, in Amending Section 23(a), Used the Phrase "All the Ordinary and Necessary Expenses" in the Same Sense and with the Same Limitations that it had Previously Used in Connection with Trade and Business Expenses.

We respectfully submit that it was the purpose of the Congress not only to ameliorate the harshness resulting from the decision of *Higgins v. Commissioner,* 312 U. S., 212, 61 S. Ct., 475, 85 L. Ed., 783, but to also permit deductions of all expenses incurred in the production of income or the conservation of property held for the production of income, and that such expenses were to be regarded as ordinary and necessary even though they were expended in the defense of title to property held for the production of income. There is nothing in the statute to indicate that the definition of ordinary and necessary expenses previously adopted by the Treasury Department and the Courts with regard to the expenses in defending title to property is to be used in administering the present law. On the contrary the meaning is clear that if the expenses are ordinary and necessary in the generally accepted meaning of these words and bear a proximate relation to production of income or to the conservation of property held for that purpose, that such expenses are deductible. Any other construction would thwart the obvious purpose of the statute and therefore should not be adopted. *Helvering v. Hammel,* 311 U. S., 504, 61 S. Ct. Rep., 368, 85 L. Ed., 303, 131 A. L. R., 1431.

V

The Court Erred in Giving Effect to the Regulation of the Treasury Department with Reference to What are "Ordinary and Necessary Expenses" When it was the Clear Intent and Purpose of Congress to Declare a Different Rule.

Prior to the Amendment of 1942, and subsequent thereto, the Treasury Department has ruled "the cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense."

It is respectfully submitted that this ruling, in so far as it relates to the cost of defending title to property held for the production of income, is at variance with the statute law as it now exists and is therefore unenforceable and a mere nullity. Congress clearly said that expenses incurred in the conservation of property held for the production of income are deductible and it did not otherwise delineate such "expenses".

It was amply shown in the case at bar that the petitioner acquired nothing whatsoever by defending her title. So far as she was concerned it was merely an expense of conserving what she already had. In view of the fact that Congress certainly intended to allow expenses incurred in the conservation of property to be deductible it would seem contrary to reason and right and a too narrow construction of the statute to say that merely because the expense was connected with defense of title to stock that it could not be allowed. Such a construction would appear to put a highly technical meaning on the words "defending title", which we think was never contemplated by the Act.

The Treasury Department is without authority to amend the statute law by regulation when such statute is clear and free from doubt. This Court in *Koshland v.*

Helvering, 298 U. S., 441, 56 S. Ct. Rep., 767, 80 L. Ed., 1268, gave expression to this principle in the following language:

> "Where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. But where, as in this case, the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation." (Citing *Manhattan General Equipment Co. v. Commissioner of Internal Revenue,* 297 U. S., 129, 56 S. Ct., 397, 80 L. Ed., 528.)

We therefore submit that the Court below decided an important question of Federal law in a way probably in conflict with the decisions of this Court.

Respectfully submitted,

PINCKNEY L. CAIN,
R. BEVERLEY HERBERT,
Attorneys for Petitioner.

April 13, 1944.

No. 956

In the Supreme Court of the United States

October Term, 1943

W. P. Burnet, Collector of Internal Revenue for the State of South Carolina

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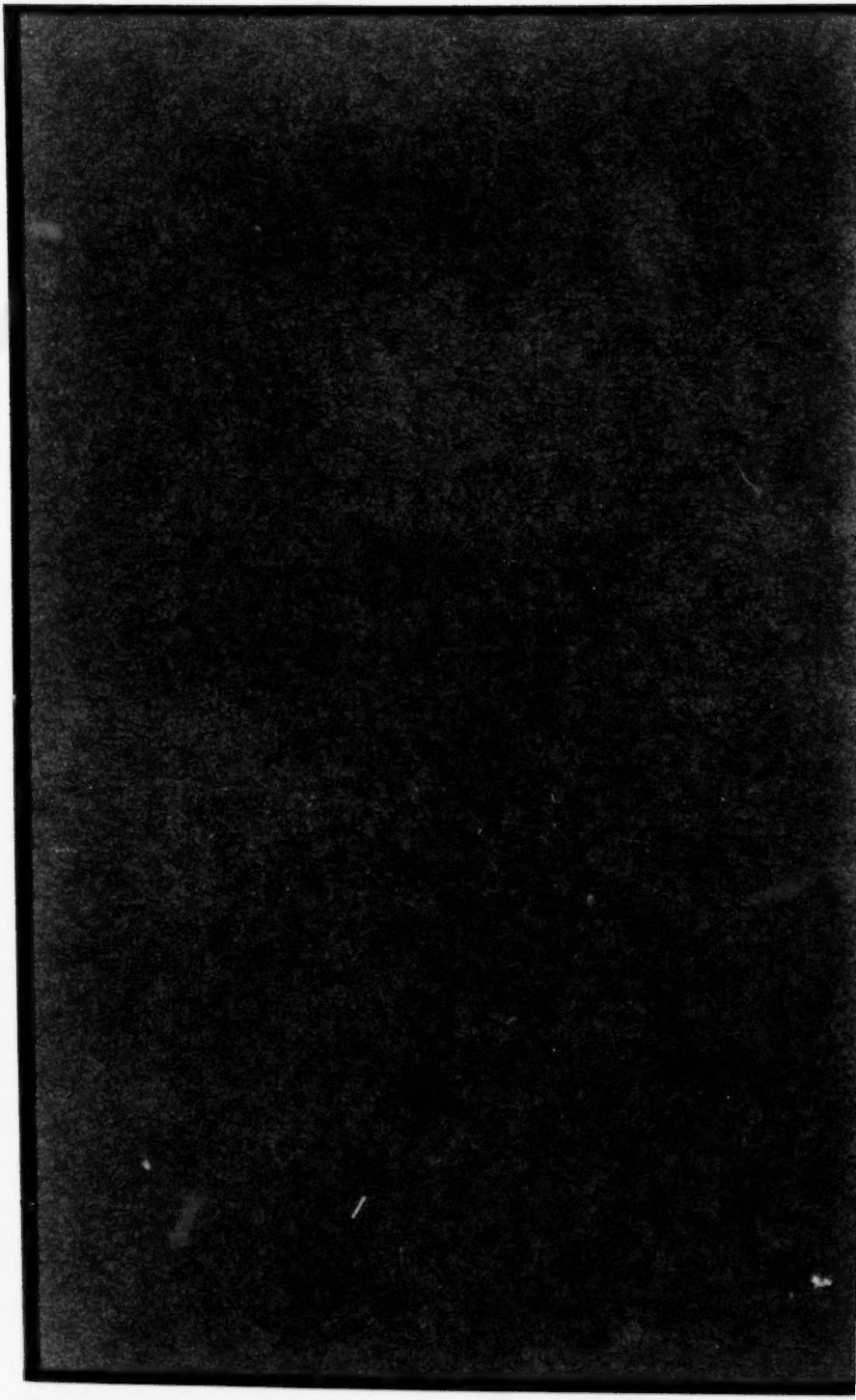
ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION



INDEX

CITATIONS

Cases:

589312—44——1

In the Supreme Court of the United States

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No. 956

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WM. P. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE STATE OF SOUTH CAROLINA

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (R. 13–19) is reported in 50 F. Supp. 874. The opinion of the circuit court of appeals (R. 26–29) is reported in 140 F. 2d 927.

JURISDICTION

The judgment of the circuit court of appeals was entered on February 4, 1944 (R. 30). The petition for a writ of certiorari was filed on May 2, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Are attorneys' fees and other legal expenses incurred in the defense of title to corporate stock capital expenditures the cost of which must be added to the cost of the stock or are they deductible as nontrade or nonbusiness expenses under the retroactive provisions of Section 121 of the Revenue Act of 1942?

STATUTE AND REGULATIONS INVOLVED

The applicable statute and regulations are set out in Appendix A, *infra,* pp. 11–13.

STATEMENT

This is a suit against the Collector of Internal Revenue for the District of South Carolina to recover individual income taxes and interest alleged to have been overpaid for the years 1936 and 1937, in a total sum amounting, together with interest, to $22,680.10 (R. 19).

The petitioner was formerly the wife of H. D. Crosswell, who, with his brother, owned equally the entire 50 shares of stock of H. D. and J. K. Crosswell, Inc. The company owned valuable franchise rights respecting the sale and distribution of Coca-Cola syrup in various counties in South Carolina from which the company received commissions or royalties. (R. 14.)

H. D. Crosswell died in 1922 and by will left his 25 shares of stock in the Crosswell Company in trust to his wife for her life. She then became

a salaried officer of the company, which was operated by her and her brother-in-law, J. K. Crosswell. (R. 14–15.)

In 1929 J. K. Crosswell died and by will conveyed his 25 shares of stock in the Crosswell Company to trustees in trust to establish and maintain an orphanage. In 1930, the petitioner purchased from the trustees of the orphanage the 25 shares of stock of the Crosswell Company for a consideration of $255,885. (R. 15.)

In 1936, the Attorney General, on behalf of the State of South Carolina, instituted an action against the petitioner seeking to invalidate the sale of the stock and for an accounting. On appeal from an adverse decision the Supreme Court of South Carolina sustained the validity of the sale. (R. 15.)

In the defense of that litigation the petitioner incurred expenses of $250 in 1936 and $26,798.22 in 1937 for attorneys' fees and other expenses, which amounts she deducted from gross income reported in her federal income tax returns. The Commissioner of Internal Revenue disallowed the deductions and assessed additional taxes and interest of $19,342.72, which were paid under protest. A claim for refund of the taxes paid was filed and upon its rejection this action was instituted against the Collector. (R. 15–16.)

The District Court for the Eastern District of South Carolina held that the amounts expended were deductible as nontrade and nonbusiness ex-

penses under the retroactive provisions of Section 121 of the Revenue Act of 1942 (R. 16–19). Judgment was entered against the Collector for $22,680.10 (R. 19). The Circuit Court of Appeals for the Fourth Circuit held that the amounts expended were capital expenditures and were not deductible (R. 26–29). It reversed the judgment of the district court (R. 30).

ARGUMENT

There is no conflict of decisions on the issue here presented and none is pointed out by the petitioner. The principal basis of the petition is that the circuit court of appeals has misconstrued the applicable statute. We submit that such is not the case.

1. The attorneys' fees and expenses incurred in the instant case were in defense of title to stock which the taxpayer had purchased. Treasury Regulations for 25 years have consistently provided that such expenses are capital expenditures to be added to the cost of the property.[1] Those regulations, by the enactment of successive Rev-

[1] Article 293 of Regulations 45 (1919 Ed.) and 62 (1922 Ed.), promulgated under the Revenue Acts of 1918 and 1921; Article 292 of Regulations 65 and 69, promulgated under the Revenue Acts of 1924 and 1926; Article 282 of Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932; Article 24–2 of Regulations 94 and 101, promulgated under the Revenue Acts of 1936 and 1938; Section 19.24–2 of Regulations 103 (1940 Ed.), promulgated under the Internal Revenue Code.

enue Acts, have been approved by Congress and now have the force and effect of law.[2]

The decided cases unanimously support the regulations and hold that amounts expended in defense of title to property are capital expenditures to be added to the cost of the property and are not deductible as expenses.[3] Many necessary payments are charges upon capital and cannot be deducted. *Welch* v. *Helvering,* 290 U. S. 111, 113–114. This distinction is illustrated in *Helvering* v. *Winmill,* 305 U. S. 79, where brokerage commissions in purchasing securities were held chargeable to capital account.

2. The taxpayer claims that the expenditures are deductible as nontrade or nonbusiness expenses under the retroactive provisions of Section 121

[2] *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 115; *Helvering* v. *Winmill*, 305 U. S. 79, 83; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 95–96; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 466; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 307.

[3] *Barbour Coal Co.* v. *Commissioner*, 74 F. 2d 163, 164 (C. C. A. 10th), certiorari denied, 295 U. S. 731; *Jones' Estate* v. *Commissioner*, 127 F. 2d 231, 232 (C. C. A. 5th); *Blackwell Oil & Gas Co.* v. *Commissioner*, 60 F. 2d 257, 258 (C. C. A. 10th); *McDuffie* v. *United States*, 19 F. Supp. 239, 247 (C. Cls.); *Murphy Oil Co.* v. *Burnet*, 55 F. 2d 17, 26 (C. C. A. 9th), affirmed on another issue, 287 U. S. 299; *Croker* v. *Burnet*, 62 F. 2d 991, 992 (App. D. C.); *Brawner* v. *Burnet*, 63 F. 2d 129, 131 (App. D. C.); *Hutchings* v. *Burnet*, 58 F. 2d 514 (App. D. C.); *Farmer* v. *Commissioner*, 126 F. 2d 542, 544 (C. C. A. 10th); *Owens* v. *Commissioner*, 125 F. 2d 210, 213 (C. C. A. 10th), certiorari denied, 316 U. S. 704; *Vernor* v. *United States*, 23 F. Supp. 532, 534 (C. Cls.).

of the Revenue Act of 1942 (Appendix A, *infra*). This amendment resulted from the decision in *Higgins* v. *Commissioner,* 312 U. S. 212, denying a deduction for expenses incurred in connection with managing the taxpayer's investments because such management did not constitute a trade or business.

Section 121 of the Revenue Act of 1942 does not allow a deduction for capital expenditures but only for certain nontrade or nonbusiness expenses proximately connected with the production or collection of income or when incurred in the management, conservation, or maintenance of property held for the production of income. The purpose of the amendment and its limitations are shown by the legislative history. S. Rep. No. 1631, 77th Cong., 2d Sess., p. 88 (Appendix B, *infra*), states:

> A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business.

See also H. Rep. No. 2333, 77th Cong., 2d Sess., p. 75.

Since Congress thus undertook to subject deductions under Section 121 to all the restrictions and limitations that apply under Section 23 (a) (1) (A) (except the requirement of being incurred in connection with a trade or business), it is apparent

that no fundamental change in existing law as to capital expenditures was intended. There is no merit in the petitioner's claim that to construe Section 121 as not permitting the deduction of capital expenditures is to restrict unduly the language of the statute, and thus to disregard various rules for the construction of statutes (Br. 5–7). The first rule for the construction of any statute is to ascertain the intent of Congress (*Harrison* v. *Northern Trust Co.*, 317 U. S. 476, 479), and the intent of Congress here is clear.

Section 121 merely creates an allowance for nontrade and nonbusiness expenses which had theretofore been held not to be available to them because not incurred in carrying on a trade or business. No new class of allowable deductions was created which would include capital expenditures and no change was made in the pre-existing law that capital expenditures are not deductible. In enacting the Revenue Act of 1942, Congress did not authorize a deduction of capital expenditures for those engaged in business. Certainly the language used in Section 121 was not designed to grant such a deduction to those not engaged in business. So radical a departure from established principles would require specific and unmistakable language.

The expenditures here were capital expenditures incurred in the defense of title to property. They were not expenses incurred in the produc-

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tion or collection of income or for the management, conservation, or maintenance of property held for the production of income as required by the statute. Capital expenditures fall in a different category. We cannot agree with the statement (Br. 15) that the "expenses bore a reasonable proximate relation to the conservation of property held for the production of income." Expenses incurred in the "conservation" of property would include such items as the wages of caretakers or the rent of a safe-deposit box for securities; they would not include capital expenditures and Congress had no intent that they should. The circuit court of appeals recognized that Section 121 broadened the scope of deductions but rightly held that it was not intended to include capital expenditures.

Section 19.23 (a)–15 of Treasury Regulations 103, as amended by T. D. 5196 (Appendix A, *infra*), interpreting Section 121, expressly excludes capital expenditures as a deductible item of nontrade or nonbusiness expense. It also provides that expenditures incurred in defending or perfecting title to property constitute a part of the cost of the property. The pertinent provisions are as follows:

> Capital expenditures * * * are not allowable as nontrade or nonbusiness expenses.
>
> * * * *

> Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses.

Decisions of the Tax Court, construing Section 121, have consistently held that attorneys' fees paid for defending title to property are capital expenditures to be added to the cost of the property and may not be deducted as expenses. *Heller* v. *Commissioner,* 2 T. C. 371, 373–374, pending on appeal (C. C. A. 9th); *Willmott* v. *Commissioner,* 2 T. C. 321, 326; *Herbst* v. *Commissioner,* decided June 26, 1943 (par. 43,309); *Jacobs* v. *Commissioner,* decided April 13, 1943 (par. 43,171). Paragraph references are to 1943–1944 P–H Tax Court Memorandum Decisions Service, where the full text of memorandum opinions may be found.

Deductions from income are not a matter of right but of legislative grace. Their allowance does not depend on equitable considerations, but the taxpayer must show that the case falls clearly within the wording of the statute. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Deputy* v. *du Pont,* 308 U. S. 488, 493; *White* v. *United States,* 305 U. S. 281, 292. There is no such showing in the instant case.

CONCLUSION

The decision of the circuit court of appeals is correct. There is no conflict or necessity for further review by this Court. The petition should be denied.

Respectfully submitted.

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MAY 1944.

APPENDIX A

Revenue Act of 1942, c. 619, 56 Stat. 798, amending Section 23 (a), Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

(a) *Deduction for Expenses.*—Section 23 (a) (relating to deduction for expenses) is amended to read as follows:

"(a) *Expenses.*—

"(1) *Trade or Business Expenses.*—

"(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; * * *.

* * * * *

"(2) *Non-trade or Non-business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

* * * * *

(e) *Retroactive Amendment to Prior Revenue Acts.*—For the purpose of the Revenue Act of 1938 or any prior revenue Act the amendments made to the Internal

Revenue Code by this section shall be effective as if they were a part of such revenue Act on the date of its enactment.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 24–2. *Capital expenditures.*— * * * The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. * * *

Treasury Regulations 103, as amended by T. D. 5196, 1942–2 Cum. Bull. 96, 97–100:

> SEC. 19.23 (a)–15. *Nontrade or Nonbusiness Expenses.*—(a) *In general.*—Subject to the qualifications and limitations in Chapter 1 and particularly in section 24, as amended, an expense may be deducted under section 23 (a) (2) only upon the condition that:
>
> (1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and
>
> (2) It is an ordinary and necessary expense for either or both of the purposes stated in (1) above.
>
> * * * * *
>
> (b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deductions under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade

or business. This includes restrictions and limitations contained in section 24, as amended. * * *

Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

* * * * *

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses.

APPENDIX B

S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87–88:

SECTION 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

* * * The amendment made by this section allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the taxable

year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income, and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as non-trade or non-business expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business.

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U. S. GOVERNMENT PRINTING OFFICE: 1944